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THE MANAGEMENT OF THE ENTERPRISE'S FINANCIAL STRUCTURE

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Abstract. *Because in the specialised financial theory the notion of structure can be found under various forms, the present work wishes to accomplish a classification of structures according to specific criteria. Our approach does not limit itself to establishing conceptual delimitation but also aims at formulating an original opinion regarding the financial structure of the enterprise and its possibilities of optimisation.*

Keywords: structure, financial structure, financing structure, optimum financial structure, the management of the financial structure.

Financial structure

The notion of *structure* refers to the internal composition of a system. It is characterised by the nature and the disposition of its component elements and it defines certain formal patterns – logical-mathematical ones – based on the connections established between the components that form the whole. The term of *structure,* used for the first time in architecture with the meaning of *the way in which the parts that compose a unity are assembled,* was afterwards borrowed by biology, physics, chemistry, mathematics, economy, and other sciences.

The occurrence of various structural conceptions was determined by M. Mesaroviç's *structural theory of systems*. *The structural* (Mesaroviç, M., 1972, p. 14) approach tries to underline certain structures that explain the characteristics and the behaviour of systems. It was adopted by almost all disciplines, leading to a diversity of structural models. According to Piaget, *structure is a system of transformations* which, in its system quality, implies the existence of laws – opposed to the properties of each element composing the system – and which preserves itself or develops by means of its own transformations (Piaget, J., 1973, p. 14). A structure has three traits: *wholeness, transformation and self-adjustability.* By adapting these traits to the financial theory, we can assert that ***wholeness*** - the group of elements in its totality - is represented by the *assembly of funds of which the enterprise disposes, owned or borrowed,* ***the transformations*** are recorded at the level of *the cost of the financing sources,* but also at the level of *the risk the enterprise is exposed to,* and ***self-adjustability*** is represented by *the possibility of modifying the structure of funds.*

If we consider the enterprise as a whole, we can speak not only of a *financial structure,* but also of a *production structure* or of a *means of production structure.* Taking into account these estimations, it can be said that the enterprise must define a

goal structure for its entire structural links. *The goal structure of the capital* - also known as *optimum ratio of indebtness* or *optimum degree of indebtness*) is given by that particular combination of the core capital and the borrowed capital that minimises costs and reduces the risk the enterprise is exposed to.

The first analyses of financial structure have been carried out in the last few years of the 19th century. At that time, *the commercial bankers and the specialists in credit dealing got the idea of comparing their beneficiaries on the basis of the proportion between the size of their own resources and the amount of the borrowed ones* (Maynard, H.B., 1974, p. 84). Also, it was accepted that the average level that was considered satisfying for the above mentioned proportion must be at least two. This was ***the first ratio*** used for analysing the financial status. Chronologically, ***the second consecrated ratio*** *was* between the *total of liabilities* and *the net accounting value of the core capital,* which had to tend to 1/1, that is, it had to use mainly the core capital. The borrowed capital had to be used as little as possible. This second ratio pointed out the correlation between the value of the attracted resources from various creditors on the enterprise's risk and the permanent invested sums in that particular enterprise by its own shareholders.

Under a financial aspect, the notion of structure is found in the specialised theory with the following nuances: ***financing structure, capital structure, and financial structure***. The discussion revolves around whether among the mentioned elements it can be established a total equivalence (meaning that all of them define the one and the same thing) or, on the contrary, these elements are completely different. In order to solve this problem we consider the presentation of some specialists' opinions as being opportune.

On a larger scale, some authors consider that:

- *The financial structure is given by the structure of the total liabilities recorded in the enterprise's balance sheet* (Brezeanu, 1999, p. 66),
- *By the financial structure of an enterprise it is understood the ratio between the short term and the long term financing* (Toma, Alexandru, 1998, p. 43),
- *The financial structure comprises the composition of the acquired capital on sources of acquisition and intervals of use as well* (Giurgiu, 1992, p. 27).

According to these assessments, we draw the conclusion that choosing the financial structure implies the choice of the ratio between the permanent and the short term capital, as well as the establishment of the weight of each financial source in the total of the liabilities recorded in the enterprise's balance sheet. In this case, *the conclusion is that the financial structure is superposed on the notion of financing structure.* Or, under this aspect, the principle of the financial equilibrium, based on the assurance of the correspondence between the duration of the uses and the duration of fund resources, is consider as being the objective and also the subject of the financing structure.

Other authors (Depallens, 1990, p. 324) consider that the financial structure of the enterprise can be defined by using the relation: 1 + (debts/core capital), but they do not mention the deadlines of the debts which have to be taken into consideration. Another representative figure of financial literature, Edith Ginglinger asserts that the reflection of the debts in the balance sheet is done not only under the aspect of their nature (exploitation debts, financial debts, or other kinds of debts), but it also depends on the debts deadline (Ginglinger, 1991, p. 59).

We agree with the affirmation according to which *if in terms of financial analysis one can speak about a structure of financing, in terms of financing decision taken on average and long lengths of time one cannot consider anything else but the idea of a strategic financing structure, therefore of permanent capital.*

We estimate that the differentiation element is represented by the *deadline of debts* (of the borrowed funds); while the financing structure comprises the totality of elements (no matter their nature and the period for which they are acquired by the enterprise), the financial structure is defined on the basis of financing sources on average and long term. *The proportion that is established between the financial structure and the financing structure is the proportion between a part and a whole.*

In this approach, the differentiation of the *financing structure* from the *financial structure* – also known as *the structure of the permanent capital* or *the capital structure* – can be expressed in the following way:

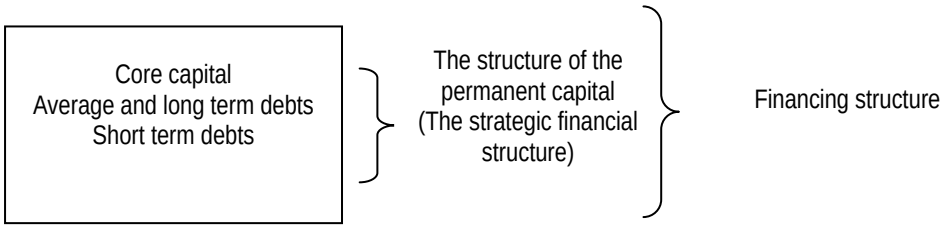

Figure 1. The representation of the financial and of the financing structure

The preoccupations regarding the improvement of the financial structure will have as a goal the accomplishment of average and long term financial equilibrium. In this case, two observations are imposed: a) if the enterprise disposes of a short term financial equilibrium with a favourable evolution, the accomplishment of the long term financial equilibrium will be possible without generating too many risks for the enterprise; b) if the accomplishment of the short term equilibrium is poor, then the probability of the accomplishment of long term equilibrium is affected too; more so, the well functioning of the enterprise may be put in danger.

Even so, *the preoccupations regarding the improvement of the financing structure will aim at accomplishing financial equilibrium on both short and average/long terms.* The enterprise's financial equilibrium approach made by considering the financing structure is more complex, but also more complete; this is because the improvement of the current financing represents a compulsory premise in order to assure long term financial equilibrium.

Once the financial structure of the enterprise is defined, we will proceed to debates regarding the optimum financial structure. In order to do this, one must consider certain assertions about the notion of *optimum.* In current speech, the notions of *choosing the optimum version* or *the most efficient version, the optimisation of the financial structure, the optimisation of the investment programmes, render an action efficient* are frequently used, without paying proper attention to the correlation between *optimum* and *efficient*.

The notions of *optimum* and *efficient*

According to *The Management Dictionary* (Fundătură, 1992), the word ***optimum*** (coming from the Latin *optimus*) means *the best, that assures the highest value, the most efficient work, what corresponds the most to the one's interests.* In the operational research, ***optimisation*** is a technique used for choosing and applying the best solution or for obtaining the best situation. Because the idea of optimisation derives from the hypothesis that all the data of a certain situation is variable, one is compelled to find (and at the same time to achieve) that particular combination of costs and advantages that offers the best solution.

From a finite number of versions, one will have the highest quality, will be the best, the most efficient; this is the optimum version we are looking for. If the activities (the enterprises) will be classified, according to the obtained results, in activities (enterprises) that make profit and activities (enterprises) that have losses, a graphical representation of the optimum will be:

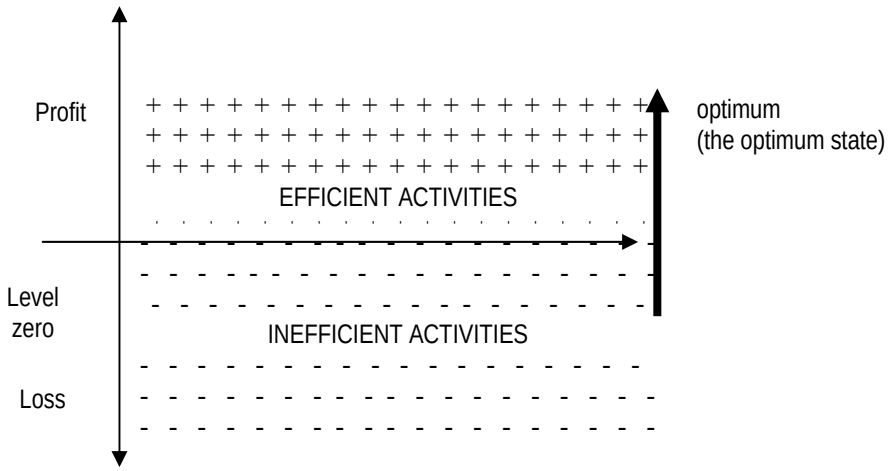

Figure 2. The graphical representation of the optimum

The profit represented the global sum of the useful effects of a certain action. The efficient activity starts when the level that records losses (level zero) has been

surpassed and ends with the optimum activity. In practice, the elaborated versions will be situated in the „+" interval, in a specific order, depending on their efficiency degree.

One of the domains of optimisation applicability is represented by the financial structure. As the structural elements are variable, they can be combined in such a manner in which the *maximisation of the enterprise's value* will be attained. This includes the maximisation of the enterprise's market value, in the context of minimising the costs implied when obtaining capital.

Some authors (Halpern, P. s.a., 1998, p. 631) agree with the existence of *a policy of capital structuring.* This policy of capital structuring, like all other policies, supposes a coordinated assembly of means, instruments and techniques used to attain a better organisation of the enterprise from a financial point of view. *The policy of capital structure implies the equilibration of the risk factor with the profitability rate.* The use of borrowed capital in a higher degree determines the increase of the risk factor regarding the firm's incomes. A higher debt rate implies at the same time a profitability rate that is estimated at a superior value. A higher degree of risk associated with a higher debt rate tends to lower the price of stocks on the market, but the estimation of a superior profitability rate leads to a higher market price. The optimum structure of the capital is the one that accomplishes equilibrium between the degree of risk and the estimated profitability rate; this way, the price of stocks on market is maximised.

If one considers *the cost of the financing sources,* it can be appreciated that the optimum financial structure is the structure that minimises the cost of obtaining funds and therefore leads to an increase of the enterprise's value. Taking into account these considerations, some authors (Charreaux, G., 1989, p. 192) have reached the conclusion that the relation between *the structure of the enterprise's capital, the cost for its obtaining and the value of the enterprise is a very complex one and almost always contradictory because it is influenced by subjective factors.* From the perspective of these considerations, we appreciate that the relation between *the financial structure, the costs of obtaining funds and the enterprise's value* can be represented this way:

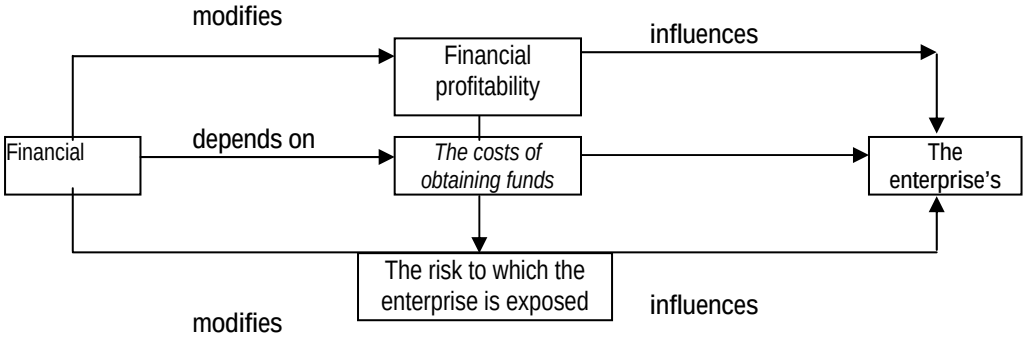

Figure 3. The representation of the relation
financial structure – the cost of obtaining funds – enterprise value

By the above mentioned aspects, we estimate that the management of the financial structure represents the corner stone of the enterprise's value maximisation. On the other hand, only when the management is efficient the premises of financial structure optimisation can be drawn.

The premises of financial structure optimisation. Even if he does not shake to the ground the mathematical theories of optimisation, Frisch is one of the initiators of the rigorous application of the elementary maximisation and minimisation theories in economics. More so, he is among the first important economists who applied mathematics in economic theory. *The optimisation methods are formally applied to a function (e.g., the costs function, profit function, utility function) with one or several variables (that can be subjected to a* ***system*** *of restrictions).*

In order to define the notion of *system,* one must start with another notion that was previously discussed, namely ***the structure of a system***. On the basis of the group theory, the concept of *system* can be defined as: *M – group of objects, P – a certain property and R – a relation inside the M group; the objects belonging to the M group form a system only if a predefined relation (R) is formed on the basis of the given objects, with fixed properties (P).* This affirmation can be transposed in the financial field:

- M – group of elements: *core capital and borrowed capital*
- P – the property: *all the capital used by the enterprise has a cost;*
- R – the relation inside the group: *the volume of the borrowed capital can be at most two times bigger than the core capital.*

Starting from this representation, one can define the goal: the optimisation of the enterprise's financial structure. In other words, the optimisation of the financial structure can lead to an improvement of the organisation and of system function. In our case, the system is the enterprise. The financial decision-makers must define a combination of the *M* group elements depending on the costs that will maximise the enterprise's value on the market. By accomplishing this final defined objective, favourable premises will be created for both shareholders and creditors; this will have a positive impact on the future development of the enterprise.

However, when dealing with the optimisation issue, in terms of economic theory, we consider that it must not be adopted a *fixed, rigid* attitude. As long as the maximisation and the minimisation are matters of dynamics, the ratio between the useful output and the superior quality input will define the premises of optimisation.

When an enterprise records its maximum level of efficiency, and thus the minimum cost level of the capital (the optimum level), it is compulsory to express the environmental circumstances – exterior and interior environment, financial or of any other nature – that allowed the accomplishment of this objective.

The issue of optimising the financial structure can be transposed in ***paretian*** terms. The paretian optimum is implicitly accomplished when the competitive equilibrium is assured; according to Pareto, efficiency represents a superior economic rationality. In this context, two observations are imposed:

- At the level of public economy, the state is defined as representing the citizen's interests; at the level of the enterprise, the interests belong to the shareholders, to those in debt, to employees, to managers;
- If at a macroeconomic level the optimum can be replaced by a generic issue of altruism and justice, *at a microeconomic level the optimum becomes a matter of forced choosing; this choice is not accompanied by a preceding moral value and does not consider equity or justice.*

Even so, the paretian optimum, debated in the context of public economy, can be expressed by two fundamental theorems, which we consider adaptable at a microeconomic level:

- The first theorem shows that, under certain circumstances, the competitive markets lead to a *special* allocation of resources: resources cannot be allocated so that somebody could improve his/her status without someone else deteriorating his/her situation at the same time; *this theorem, transposed in terms of financial structure optimisation, could be formulated as following: the minimisation of the cost of capital by an enterprise supposes a reduction of payment to the capital providers (shareholders and creditors); in other words, the positive aspect recorded by the enterprise was accomplished through a diminution of the gain of shareholders and debt payers;*
- The second theorem, entitled „the theorem of social well-being" states that an allocation that reaches an yield increase can assure a supplementary income to a person without affecting the income of another person; *when transposing that into financial analysis terms, regarding the optimisation of the financial structure, this theorem could be formulated as following: the minimising of the capital cost operated by an enterprise must be accomplished in the context of the maximisation of the enterprise's value; the correlation of the two objectives will allow the achievement of paretian well-being.*

The graphical representation of the two theorems can be rendered as following:

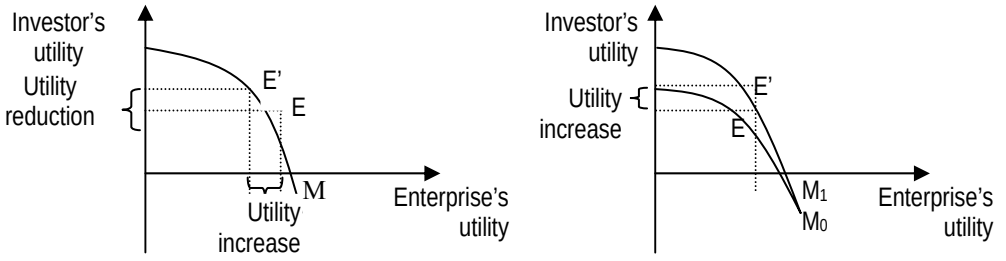

Figure 4. The transposition of the paretian theorems in the case of the enterprise's financial structure optimisation

Even if the Paretian model was conceived on the basis of the premise that markets with a homogenous structure and with a perfect competition exist, we will take responsibility for this transposition, by appreciating that the second theorem is in fact the premise of financial structure optimisation. The optimisation of the financial structure when the cost of the capital is minimised and the enterprise's value is maximised satisfies both the enterprise's and the shareholders' interests (the shareholders will benefit from a remuneration that is superior to the yield rate without risking), as well as the creditors' interests, who are willing to place their capital in a viable enterprise, without taking major risks.

The premises for achieving the optimisation of the financial structure are not only financial but they also extend outside this department and comprise the product policy, the price policy, the sales policy, the possibility of discovering new outlets even outside the country, and so on.

We consider that the purely financial premises that constitute the base for achieving an optimum capital structure are: knowing *the typology of the enterprises* because, depending on their dimension, the organisations have access to different sources of financing; knowing *the financing needs* of the enterprises; knowing *the weight of participation for different financing sources* at the enterprise level; knowing *the cost of the financing sources* and *the fluctuation of the interest rate;* knowing *the financial environment at a macroeconomic level and of the financial-monetary policies* – fiscal, monetary, credit, income – promoted in a given length of time; we also include here *the degree of development and functionality of the capital markets* because through them the enterprises can attract resources corresponding to various time horizons; knowing *the behaviour of the parties that participate on the financial market and their willingness to take risks;* knowing *the psychological implications of indebtness,* because the financial structure of an enterprise will be greatly influenced by the attitude of the financial decision-makers regarding the possibility of falling into debt.

Conclusions

The recent developments explain the structure of the capital by using other considerations that are not purely financial, such as: *the agency cost, the informational asymmetry, and industrial, commercial and external development strategies.*

The structure of the capital depends on the *agency cost.* This cost is the result of the conflict of interest between the managers who do not own the enterprise and shareholders. When the profit is distributed to the shareholders and not to the managers, the latter are inclined to make the minimum effort in order to administrate the organisation. However, when the managers own a part of the capital, they are actively engaged in the organisation's administration. Thus, the more the manager is involved, the better the results of his/her administration will be.

Informational asymmetry establishes the link between the pattern used to finance an enterprise – stock issue, indebtness, and internal resources – and the enterprise's "state of health". Managers can use information available about debts in order to send a signal on the market regarding the enterprise's quality. According to the signal theory, the majority of debts leads to an increase of the risk factor and warns the market about an improvement of the cash-flows necessary to cover the financial expenses.

External growing strategies are made by acquisitions and merging. When a firm buys actives by another firm, it is an acquisition; if two or more firms put together their capital in order to create a new organization, they talk about merging. Acquisitions and merging are an alternative to growing strategies, in the conditions of increasing competition, developing new technologies and saturation of markets in many activity areas (Clipa, R.I., 2008, p. 179).

The strategy of an enterprise can explain the structure of its capital. Actually, the structure can depend on a certain number of variables, such as the elasticity of the offer and of the product demand, the degree of competitive resistance, market organisation, etc. This approach is based on the influence of debts over the strategic variables and on the supplier-consumer relationship. The strategic variables are price and quantity. The strategy of the organisation is determined in such a way so that it influences the attitude of the competition. Because of this, the structure of capital has consequences on the strategy and on the results of each organisation at market equilibrium. As for the characteristics of the production process, the capital structure can have an effect over the availability of a product or service and on the negotiation process between managers and suppliers.

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